IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 84 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE B.C.PATEL
and
Hon'ble MR.JUSTICE D.A.MEHTA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME-TAX

Versus

GUJARAT CARBON LTD.

Appearance:

MR AKIL QURESHI for MR MANISH R BHATT for Applicant

MR JP SHAH for Respondent

CORAM : MR.JUSTICE B.C.PATEL
and
MR.JUSTICE D.A.MEHTA

Date of decision: 05/12/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE D.A.MEHTA)

#. Income-tax Appellate Tribunal, Ahmedabad Bench, "B" has referred the following question at the instance of the Commissioner, under Section 256 (1) of the Income-tax Act, 1961 (hereinafter to be referred to as "the Act").

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is right in law in holding that the amount paid for royalty to collaborators is revenue expenditure?"

#. Assessment Year is 1980-81 and the relevant accounting period is year ended on 30th June, 1979. Assessee, a Limited Company entered into a collaboration agreement for obtaining technical know-how as well as various services in respect of spot technical assistance to promote sale of furnished carbon black manufactured by the assessee. Pursuant to the agreement, the assessee Company paid a sum of Rs. 22.25 lacs for obtaining technical know-how and this sum was capitalised by the assessee in its books of accounts. Over and above this lumpsum payment, the assessee was required to make payment of royalty based on figures of sales as provided in the agreement for a period of 5 years in return for various services which were to be rendered by the collaborator.

#. Income-tax Officer held that after the expiry of the period of 5 years, license issued to the assessee Company did not revert back to the collaborator and the assessee became the owner of the technical know-how and thus, the assessee acquired benefit of enduring nature which was in the capital field. He therefore disallowed the expenditure incurred on payment of royalty treating the same to be capital in nature. The Commissioner (Appeals), treated the royalty payment of Rs. 18,52,562/= as revenue expenditure and this decision is confirmed by the Tribunal by dismissing the appeal of the Revenue.

#. Mr. Akil Qureshi, learned counsel appearing for the applicant-Revenue and Mr. J.P.Shah, learned counsel for the respondent - assessee have been heard. We do not find any infirmity in the order of the Tribunal to take a different view of the matter for the reasons that follow.

#. The Tribunal has taken into consideration the fact that the assessee had entered into two separate agreements on 8th May, 1975 and 26th November, 1975. It has been found by the Tribunal that under the first agreement dated 8th May, 1975, the assessee was required to pay over and above the lumpsum amount, a sum of 2% of

the net sale price payable annually for 5 years from the date of production i.e. the first time when the plant went into operation, but to be computed at the end of the year. On going through various clauses of agreement, the Tribunal has recorded that the agreement fell into two parts - one pertaining to supply of detailed process designs for manufacturing of mechanical plants and putting the same into working conditions, and the second pertaining to after installation services dealing with the services of technically qualified persons to provide spot technical assistance to promote sale of furnished carbon black manufactured by the assessee.

#. In relation to second agreement dated 26th November, 1975, the assessee was required to make payment of royalty at the rate of 3% of the net ex-factory sale price. As per terms of the said agreement, it has been found by the Tribunal that the same pertained to supply of information on day-to-day developments in the range of products manufactured by the assessee - Company and pertaining to the research carried out by the collaborator.

#. On appreciation and reading of both the documents, the Tribunal has held that the payment of royalty under both the agreements was directly relatable to services which were in revenue field. Referring to the first agreement, the Tribunal has categorically found that the payment pertained to services in respect of the stage after installation of the plant and hence was allowed as revenue expenditure. In relation to the second agreement, the Tribunal has once again recorded a finding that the supply of information as regards day-to-day developments in view of the research carried out by the collaborator was only for the purposes of obtaining information as to range of products manufactured by the assesee and hence was on revenue account.

#. Mr. Qureshi heavily relied upon the decision of the Apex Court in the case of Jonas Woodhead and Sons Ltd. vs. Commissioner of Income-tax [224 ITR 342] to submit that in the case of such agreements, namely the first agreement dated 8th May, 1975, a part of the expenditure in question has to be treated as capital in nature, because according to him, the agreement itself provided for acquisition of technical know-how which was capital in nature. The Apex Court, in the case of Jonas Woodhead and Sons Ltd. (supra), after referring to its earlier decision in the case of Alembic Chemical Works Co. Ltd. vs. Commissioner of Income-tax [177 ITR 377] has carved out the following principles from the said decision.

"(i) It would be unrealistic to ignore the rapid advances in research in antibiotic medical microbiology and to attribute a degree of endurability and permanence to the technical know-how at any particular stage in this fast changing area of medical science. The state of the are in some of these areas of high priority research is constantly updated so that the know-how could not be said to bear the element of the requisite degree of durability and nonephemerality to share the requirements and qualifications of an enduring capital asset. The rapid strides in science and technology in the field should make us a little slow and circumspect in too readily pigeonholing an outlay such as this, as capital.

(ii) In the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue arises, it is well nigh impossible to formulate any general rule, even in the generality of cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation. However, some broad and general tests have been suggested from time to time to ascertain on which side of the line the outlay in any particular case might reasonably be held to fall. These tests are generally efficacious and serve as useful servants; but as masters they tend to be overexacting.

(iii) The question in each case would necessarily be whether the tests relevant and significant in the case on hand also. Judicial metaphors are narrowly to be watched, for, starting as devices to liberate thought, they end often by enslaving it.

The idea of `once for all' payment and `enduring benefit' are not to be treated as something akin to statutory conditions; nor are the notions of `capital' or `revenue' a judicial fetish. What is capital expenditure and what is revenue are not eternal verities but must needs be flexible so as to respond to the changing economic realities of business. The expression `asset or advantage of an enduring nature' was evolved to emphasise the element of a sufficient degree of durability appropriate to the context.

There is also no single definitive criterion which, by itself, is determinative whether a particular outlay is capital or revenue. The `once for all' payment test is also inconclusive. What is relevant is the purpose of the outlay and its intended object and effect, considered in a commonsense way having regard to the business realities. In a given case, the test of `enduring benefit' might break down."

In the aforesaid decision of the Supreme Court in the case of Jonas Woodhead and Sons (India) Ltd. (supra), it is also stated that various clauses of the agreement were to be examined bearing in mind the changing economic realities of the business and varieties of situational diversities. It was in light of this observations that the decision of the High Court was confirmed by stating that the High Court had considered the different clauses of the agreement. In the case in hand, the Tribunal has carried out the said exercise, but before this Court, when the relevant agreements are not placed on record, it is not possible for the Court to examine the various clauses of the agreement as required.

#. Therefore, applying the aforesaid test, it is apparent that there cannot be a single definite criteron which by itself would be determinative as to whether an expenditure has been incurred in the revenue field or the capital field. Mr. Qureshi also relied upon and emphasized (the factor) that even after the expiry of the period of 5 years, the assessee was entitled to the technical know-how and continue to carry on manufacturing the same products and furthermore, the assessee was not required to return the design etc. to the collaborator. He therefore submitted that in view of this position, it was apparent that the assessee had acquired a benefit of enduring nature and hence atleast a part of the expenditure in question had to be treated as capital expenditure. In this connection, it is pertinent to note that in the case of Commissioner of Income-tax v. Jyoti Electric Motors (2000) 244 ITR 99, this Court has held that even in a case where the assessee is entitled to retain all the technical data, design, documentation etc., and there was also no restriction on manufacturing, even then payment of royalty was allowable as revenue expenditure in view of the fact that the assessee was not a new unit engaged in manufacturing as the benefit was acquired only for running an existing business.

##. Mr. Qureshi vehemently contended that the findings

recorded by the Tribunal on the basis of the reading of the documents in question give rise to anomaly and in view of the same, the Court must hold that the assessee was not entitled to claim deduction on revenue account the entire sum of royalty paid atleast in relation to the first agreement. We are not in a position to render any opinion on this aspect of the matter in the absence of the relevant agreements on record.

##. It is necessary to note at this stage that whenever any party challenges any interpretation of any document, primarily it would be the duty of that party to place such document on record so as to enable the Court to appreciate whether the lower authorities have rightly read the documents. As stated, in absence of the relevant agreements, it is not possible to appreciate and deal with this contention raised.

##. In light of what is stated hereinbefore, we hold that the Tribunal was right in law in holding that the amount of royalty paid to collaborator is revenue expenditure. The question referred to us is answered in the affirmative i.e. in favour of the assessee and against the Revenue. The Reference stands disposed of accordingly with no order as to costs.

[B.C. PATEL, J.] [D.A. MEHTA, J.]

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